Payments on account in respect of disputed sums

Kathryn Coyne and James Pickavance of Eversheds discuss the practice of paying moneys on account in respect of disputed items, the risks of doing it and how to try and ensure the risks are minimised.

The following will be a tale familiar to many working in the construction industry: the contractor makes an interim application for payment, which the contract administrator subsequently certifies at a lower amount because he considers an item or items within the application are worth less or are invalid. The contractor records that item or items as disputed in future interim applications. Acknowledging both the dispute and the contractor’s need for cash flow, the contract administrator certifies the sums for some or all of those disputed items as due ‘on account’ until a fixed point in time or until the dispute is resolved.

This approach is understandable in the context of on-going projects where relationships and, more importantly for the contractor, cash flow needs to be maintained. However, what is the contractual status of such payment? Does it constitute an implied acceptance or a waiver of the employer’s rights? Can the money be recovered if it is determined that it should not be paid? Can and, more importantly, should a payment like this be made in the first place?

Payment of sums considered due

Provisions relating to payment in contracts falling within the scope of the Pt II of the Housing Grants, Construction and Regeneration Act 1996, as amended (HGCRA 1996) must meet certain criteria set out therein. Where they do not, the offending provisions will be struck out and replaced by the relevant provisions of Pt II of the Scheme for Construction Contracts.

In order for payment provisions to comply with the HGCRA 1996, contracts must: make provision for staged payments; contain an adequate mechanism for determining what payments become due under the contract and when those payments become due; include a requirement to issue a payment notice within five days of the due date; and specify a final date for payment of the sum certified as due. The payment notice to be issued by the employer must specify the sum that the contract administrator considers is due at the payment due date and on what basis such sum was calculated. Payment notices produced during the course of the works are often termed interim certificates.

Interim certificates are issued to establish the amount due, and to be paid in an interim payment by the employer to the contractor, during the course of the works. While interim certificates are not finally binding on the parties, they provide the contractor with a right

**KEY POINTS**

- Payments included in interim certificates are payments considered validly due at the time of such certificates
- There is no mechanism for making payments for sums which the employer considers the contractor is not entitled to and are therefore not due
- Including payments on account for disputed sums in interim certificates carries various risks which mean the employer may not be able to recover such overpayment
- Precautions can be taken to mitigate the risks of making a payment on account in respect of issues in dispute
to payment and the employer must usually pay the sums set out in the interim certificate by the final date for payment. If the employer wishes to pay less than the sum stated as due in the interim certificate, the contract administrator must issue a pay less notice before such final date.

A later interim certificate may revise the sum previously certified. The sum certified in an interim certificate should not therefore be considered a definitive or true value of the works completed, at the date of the certificate, but merely what, in the opinion of the contract administrator, is due on the basis of his latest inspection and information. The final determination of the contractor’s entitlement is not made until the final certificate. The interim payments are therefore sums paid on-account of whatever the contractor might eventually be entitled to recover from the employer.

Most standard forms provide that the interim certification is not binding nor conclusive of acceptance of work, and allows the paying party to make corrections in later certificates for example, cl 50.5 and 51.3 in NEC3 2013, cl 4.12 JCT Design and Build 2011 (it is only the final certificate which is conclusive) and cl 14.6 in the FIDIC suite.

Paying disputed sums ‘on-account’
The normal process for payment under construction contracts (either pursuant to the HGCRA 1996 or as per the standard form contracts) does therefore envisage payments being made ‘on account’ to contractors. However, although such payments may be revised at a later date, the basic premise is that at the time such payments on account were made, the paying party considered such payments to be due. Neither the HGCRA 1996 nor the standard form contracts make provision for making on account payments where the paying party does not consider, or is not sure, if such payment is due and the amount sought is disputed.

There is therefore no standard mechanism which allows payment of a disputed amount, which is not considered due to the contractor by the employer (or the contract administrator), to be made on account until such time as the parties resolve the issue in dispute. The expectation is that the issue in dispute will be resolved first in order to establish what sum is properly due.

If a sum is included in an interim certificate it is considered validly due by the contract administrator and the employer must pay such sum by the final date for payment. To modify sums paid in later certificates there must be a valid ground for doing so.

What are the risks?
Whilst the consequence of making a payment on account in respect of a disputed item will depend on the facts, the following are the types of risks which may arise.

Shift in the burden of proof
The most significant risk is that doing so shifts the burden of proof from the contractor to the employer. The general rule in English law is ‘he who avers must prove’. Where a contractor makes a claim for additional money the burden of proof is on the contractor to prove that it is entitled to such money. Once the employer has made payment to the contractor it is for the employer to prove that it is entitled to recoup such money, rather than for the contractor to prove it is entitled to keep it.

In the Scottish case of SGL Carbon Fibres Ltd v RBG Ltd [2012] ScotCS CSOH 19, Lord Glennie in the Outer House, Scottish Court of Session, dismissed an appeal by an employer against an arbitrator’s decision. It held:

- The contractor bore the burden of proof when claiming additional payments above what it had already received.
- The employer bore the burden of proof when attempting to recover sums allegedly overpaid to the contractor.
- Any assessment made by the contract administrator, and any certificate issued by him, was capable of being corrected by a subsequent assessment and certificate.
- The non-binding nature of a project manager’s assessment and payment certificate did not mean that they should be ignored when working out the final account or when one party sought additional payment or recovery of an overpayment. The certified sum was (and remained for the purpose of any future calculations) the sum due at the assessment date, unless corrected by the project manager (or the adjudicator or the arbitrator). A party challenging a prior assessment must ‘bear the burden of persuasion.’
- While Lord Glennie’s opinion is not binding on the English courts, it does support the general...
principles of burden of proof. Making a payment on account to the contractor in respect of disputed items switches the burden from the contractor, to prove it is entitled to such moneys, to the employer to prove that the contractor is not entitled to such sum and that it should be able to recover such moneys from the contractor, by way of pay less notices, or otherwise. The position of the employer is therefore significantly weakened by making a payment on account in respect of disputed items.

Implied acceptance
Payments on account in respect of disputed items may inadvertently act as an implied acceptance of the contractor’s entitlement by the employer.

The common scenario giving rise to such on account payments is where the contractor’s entitlement to additional money under the contract is in dispute. As outlined at the start of this paper, the contractor may include disputed items in its interim applications. If the employer makes a payment in respect of such disputed items, despite such sums being considered disputed and not validly due, this may in effect amount to an acceptance that the contractor is entitled to the sum applied for.

Waiving other rights in the contract
Making a payment on account in respect of a disputed sum may cut across other rights the employer may have in the contract. For example, many standard forms contain conditions precedent to the contractor being entitled to claim additional money, which if not satisfied will bar the contractor’s entitlement to make such a claim. Making a payment on account, where the contractor has failed to comply with the conditions precedent in applying for such additional sum, implies an acceptance of the contractor’s right to claim and may, therefore, amount to a waiver of the employer’s right to rely on the conditions precedent within the contract.

Ability to recover moneys paid
A more practical issue is the risk of there not being sufficient moneys remaining due to the contractor, under the contract, from which over-payments can be recovered.

The simplest way for an employer to recover overpayments is to deduct such overpayments from amounts otherwise due to the contractor in future interim certificates. If the amount remaining to be paid to the contractor is less than the overpayment to be recovered, it may prove more difficult to get the contractor to pay back such moneys, either because the contractor disputes that it is required to do so, or because the contractor is unable to do so, because of the contractor’s insolvency for instance.

Precautions
The best precaution against the risks of making such a payment is not to do it. Standard form contracts and the HGCRA 1996 provide mechanisms for resolving disputes during the course of the works. Most notably adjudication was introduced to deal with money disputes and encourage cash flow in construction projects. Ideally the dispute resolution tools available would be used to resolve disputes as they arise, in order to avoid making payments on account in respect of disputed items.

However, it is recognised that doing so is easier said than done. If the scenario as set out at the start of this article does arise, and payment of disputed sums is to be included in interim certificates, the following precautions can be taken to mitigate the risks created by making such payment (though none are guaranteed to eliminate such risks):

- The disputed sum paid on account should be clearly distinguished from other sums considered validly due in the interim certificate.
- It should be recorded in writing, that the payment on account of the disputed sum is paid without any acceptance of the contractor’s entitlement to such sum or the employer’s liability to pay such sum.
- Further, it should be recorded in writing that it remains for the contractor to prove entitlement to such sum – the burden of proof has not shifted to the employer.
- The contract administrator should make sure that there is sufficient money remaining due to the contractor, against which any overpayments can be recovered.
- Finally, consider the financial strength of the contractor. Whilst amounts validly due must be paid to a contractor, even where there are concerns as to their solvency, there is no requirement to pay moneys which are disputed and not considered due. CL